



Office of Inspector General

July 2015



Business Loans

Illinois Man Pleads Guilty to Mail Fraud and Aggravated Identity For Fraudulently Completing Credit Applications

On July 14, 2015, an Illinois man pled guilty in Federal court to mail fraud and aggravated identity theft. The investigation showed that, between 2006 and 2008, he and another co-owner of a property management firm obtained individuals' personal identifying information and made false statements in applications for lines of credit and credit card accounts without the consent of the purported applicants. During the same time, they fraudulently obtained a \$35,000 SBA-guaranteed loan. As part of their scheme, the pair used the personal identifying information of a mentally disabled man. They caused the man to sign personal guarantees for mortgages, bank loans, and the SBA loan, despite knowing that the man did not have the financial means or mental capacity to repay the loans. Loan proceeds were used for purposes unrelated to the business.

The investigation also found that, between 2006 and 2011, the two co-owners and a licensed loan officer took part in a mortgage fraud scheme to obtain more than \$2.1 million in mortgage loans for 14 properties. The three prepared and submitted false documents and made false statements to lenders.

Finally, between 2010 and 2012, the co-owners and two other men submitted at least 40 fraudulent applications for Federal student aid using stolen identities. These individuals used the proceeds for themselves and others for purposes unrelated to educational expenses. This is an ongoing joint investigation with the

Department of Education Office of Inspector General (OIG), the Federal Housing Finance Agency OIG, the Department of Housing and Urban Development OIG, and the FBI.

California Attorney Sentenced to 2 Years in Prison for Involvement in \$4.5 Million Fraud Scheme

On July 20, 2015, a California attorney was sentenced in Federal court to 2 years in Federal prison and 36 months of supervised release for his involvement in fraudulently obtaining SBA Section 7(a) guaranteed business loans. He previously had pled guilty to wire fraud for his participation in a scheme in which a father, his stepdaughter, and a former attorney defrauded a small business lending firm of proceeds from loans to purchase two California gas station businesses. The SBA loans totaled approximately \$4.5 million. On July 24, 2015, he was sentenced in Federal court on additional charges unrelated to the SBA loans.

The attorney and father formed a petroleum company while the attorney was representing the father in Federal court for defrauding SBA and financial institutions to obtain approximately \$5 million in business loans to purchase a gas station and car wash business. The father did not want the small business lending firm to discover his poor credit and pending litigation. Consequently, he, his stepdaughter, and the attorney recruited a former attorney with a good credit history to pose as the petroleum company's owner. After the loans to purchase the gas stations were completed, ownership of the petroleum company would be transferred to the father, without

informing the lender. In addition, the attorney, the former attorney, the father, and others represented to the lending firm that the former attorney and the petroleum company were making a \$2.1 million down payment, when in fact no such payment was made. After the loans were funded, the attorney received \$250,000. His restitution hearing is forthcoming, with the loss to the lender being approximately \$3.6 million. This investigation was conducted jointly with the FBI.

Washington Bar Owner Indicted for Bank Fraud and Conspiracy to Commit Bank Fraud

On July 23, 2015, a Washington State 7(a) loan applicant and owner of multiple bars in Spokane, WA, was indicted in Federal court for bank fraud and conspiracy to commit bank fraud, and was issued a notice of criminal forfeiture. The charges originated from a joint FBI and Internal Revenue Service (IRS) inquiry into the man's financial business affairs. He and a co-borrower applied for and were awarded a \$298,000 SBA loan by allegedly providing false financial and criminal history information. Further investigation has shown that the man allegedly provided approximately \$70,000 of the loan proceeds to an acquaintance who allegedly used the funds to fraudulently procure a mortgage loan. Additional alleged illegal acts include violation of the Soldiers and Sailors Relief Act, tax violations, and additional bank and mortgage fraud schemes. This is an ongoing joint investigation with the FBI and IRS Criminal Investigation (CI).

Real Estate Agent Ordered to Pay \$646,124 in Restitution

On July 23, 2015, a real estate agent and wife of the owner of a Denver real estate firm was ordered by a State court to pay \$646,124 in restitution. She had previously pled guilty to violating the Colorado Organized Crime Control Act and was sentenced to 3 years of probation. The woman was originally indicted with her husband and four other family members in a 37-count indictment that included charges of violating the Colorado Organized Crime Control Act, attempting to influence a public servant, criminal impersonation, conspiracy, theft, and committing forgery and making false statements to SBA, the State of Colorado, and various lenders.

The investigation showed that her husband obtained a \$2.3 million SBA-guaranteed loan to refinance his office building and other debt. To obtain the loan, he concealed his extensive criminal history and the fact that he was currently on probation. He also falsified documents related to his debts and the taxes owed to the State of Colorado. It was also discovered that the woman and her husband, along with four other family members, created a criminal enterprise using their status as real estate professionals to execute a large, long-term fraud for profit scheme. The scheme primarily centered on mortgage fraud, including but not limited to manipulating multiple real estate transactions through using fraudulent statements, material omissions, acquiring false identification and notary commissions, and using “straw buyers” to buy and sell real estate. This case was initiated after OIG received a referral from a California bank. This was a joint investigation with the Colorado Attorney General’s Office, Colorado Bureau of Investigation, FBI, and the Federal Housing Finance Agency OIG.

Disaster Loans

Illinois Man Pleads Guilty to Bank and Disaster Loan Fraud

On July 1, 2015, an Illinois man in Federal court pled guilty to bank fraud and making false statements. His business partner had previously pled guilty to the same charges. The Illinois man had been the vice president, the chief financial officer, and a shareholder of a firm that sold and serviced industrial batteries and related products. The business partner was the president and majority shareholder of the company.

The investigation found that, from around April 2007 to May 2011, the two men submitted to a bank reports and other financial information that falsely inflated their company’s accounts receivable, sales, and inventory. The purpose was to conceal the company’s declining financial condition and prevent the bank from demanding repayment of funds and seizing company assets.

In addition, the investigation revealed that, around May 2009, the men submitted to the Small Business Administration (SBA) the same materially false information in order to receive a \$240,100 economic injury disaster loan. They submitted inflated monthly sales figures for 2007 and 2008 in their disaster loan application while knowing the sales figures were false.

Finally, the men submitted to SBA the firm’s 2008 Federal corporate tax return as a supplementary submission in order to obtain the disaster loan. The tax return falsely represented the company’s sales for 2008 as \$5.4 million, when the company’s sales were only \$3 million. The firm defaulted on the disaster loan, resulting in losses to SBA of \$222,867. This is a joint investigation with the Federal Bureau of Investigation (FBI).

Audit Report 15-13: Hurricane Sandy Expedited Loan Processes

On July 13, 2015, OIG published the results of its review of SBA’s expedited disaster loans processing. In the wake of Hurricane Sandy, SBA implemented two expedited loan processes: the Sandy Alternative Processing Pilot (SAPP), which streamlined the home loan process, and a modified Phase II method for processing economic injury disaster loans (EIDLs). Both of these processes were intended to address a backlog of loan applications in the wake of Hurricane Sandy.

OIG found that the Agency’s home loan expedited process, SAPP, slightly reduced loan application processing time by loan officers and mitigated loan default risk. However, the expedited EIDL method for business loans did not result in any time savings. Neither of the expedited methods reduced the overall time from application acceptance to initial loan disbursement. OIG also found that the SAPP memo lacked specific guidance on how to address complex loan situations. This led to SBA loan officers needing to deviate from SAPP procedures in order to more accurately determine applicants’ actual income and debt obligations. Furthermore, SBA incorrectly implemented the modified Phase II EIDL procedures in 15 loan applications, resulting in incorrect loan amounts. This was due primarily to insufficient training for loan officers. If another disaster occurs with a similar magnitude to Hurricane Sandy, the Agency could encounter similar challenges processing loans correctly and efficiently unless proper measures are timely implemented to address these deficiencies.

OIG made four recommendations. The Agency has implemented one recommendation already, and plans to implement the remaining three.

Management of Disaster Technical Assistance Grants

On July 31, 2015, OIG published the results of their audit of SBA's oversight of Hurricane Sandy technical assistance grants. The Disaster Relief Appropriations Act of 2013 gave SBA \$19 million to provide technical assistance to small businesses recovering from Hurricane Sandy. OIG focused on the two largest recipients, the New York Small Business Development Center (NYSBDC) and the New Jersey Small Business Development Center (NJSBDC), which together received \$12.6 million of the \$19 million appropriated for Hurricane Sandy technical assistance grants.

For Phase 1, the SBDCs faced challenges in operating under an initial aggressive 6-month timeline, while delivering an increased level of technical assistance services supported by multiple funding sources. However, both SBDCs were able to achieve some Hurricane Sandy goals: NYSBDC reported meeting nearly 3 of its 4 goals, while NJSBDC reported meeting nearly 2 of its 3 goals to address short-term needs. For Phase 2, NYSBDC and NJSBDC may not meet their goals for long-term resiliency. As of March 31, 2015, several of the SBDCs' goals lagged behind schedule, with \$6.6 million remaining to be spent by August 2015. Both SBDCs faced challenges with attracting technical assistance clients and spending Sandy funds concurrent with funds from other grants, including residual Phase 1 funding. The SBDCs also had difficulty collaborating with other technical assistance providers. OIG also found that SBA did not identify or mitigate the risk of unallowable expenditures during Phase 1. As a result, subcenters of the SBDCs used \$16,965 on unapproved scholarship costs, \$168,082 on unsupported personnel and indirect costs, and \$335,217 on unapproved budget revisions—all of which went undetected by SBA. SBA agreed with 9 of

OIG's 10 recommendations, and partially agreed with 1 recommendation.

Government Contracting

Virginia Company and Owner Agree to Pay \$250,000 and \$58,587 to Settle Civil Claims

On June 30, 2015, a Virginia company agreed in Federal court to pay \$250,000 to settle civil claims relating to its involvement in a scheme to create a front company for obtaining contracts through SBA's Section 8(a) Program. In addition, the company's former president agreed to pay \$58,587 to settle civil claims. He previously had pled guilty to committing major fraud against the Government. Principals of this company and a second Virginia firm falsely represented to the Government that the second firm was eligible for the 8(a) Program when in fact it was operated and controlled by the first company. The second firm received over \$31 million dollars in 8(a) and small business set-aside contracts. This case is being jointly investigated with the National Aeronautics and Space Administration OIG, the Defense Criminal Investigative Service, and the U.S. Department of Homeland Security OIG.

SBA Employee Removed from Position for Attempting to Have Improper Relationship with President of Section 8(a) and HUBZone Business

On July 3, 2015, an SBA information technology specialist was removed from his position for conduct unbecoming of a Federal employee and lack of candor. The investigation disclosed he may have attempted to have an improper relationship with the president of a Section 8(a) and HUBZone business regarding an upcoming SBA contract. This investigation

was based on an administrative referral and is ongoing.

DOJ and Graduated Maryland 8(a) Firm Reach \$7.8 Million Settlement

On July 6, 2015, the U.S. Department of Justice (DOJ) announced that a \$7.8 million settlement agreement had been reached with a graduated Maryland 8(a) firm and its principals to resolve allegations that they made false statements to obtain contracts through SBA. On August 19, 2011, in the U.S. District Court for the District of Columbia, the firm and its principals had been variously charged with false claims, false records and statements, and conspiracy under the False Claims Act, as well as negligent misrepresentations and fraud under common law. The Government decided to intervene in portions of a complaint by citizens alleging that the firm and its principals violated the False Claims Act relating to the company's participation in the 8(a) Program. The citizens claimed that the firm's former president, upon whom 8(a) eligibility was based, was neither in control of the company nor running the day-to-day operations. Consequently, the firm received millions of dollars of Government contracts for which it was not eligible. The OIG investigation supported these claims. The settlement was the result of a coordinated effort among the DOJ Civil Division, the U.S. Attorney's Office of the District of Columbia, SBA's Office of General Counsel, and OIG's Office of Counsel.

Couple Indicted for Fraudulently Applying for Government Contracts and Ordered to Forfeit At Least \$30 Million

On July 7, 2015, a second superseding indictment was issued in Federal court in connection with a couple who were the

controlling corporate officers and majority shareholders of two Maryland firms. They were both charged with wire fraud, conspiracy to commit wire fraud, money laundering, embezzlement from an employee benefit plan, tax evasion, and criminal forfeiture. They were ordered to forfeit to the United States all property involved in and traceable to the offenses, including at least \$30 million.

The two firms were awarded millions of dollars in Federal contracts set aside for small businesses and service-disabled veteran-owned small businesses. Competitors had protested such awards to the firms several times, based on affiliation issues and size determination matters. Each time, SBA had found the firms to be small businesses. This investigation is being conducted jointly with the IRS, Defense Criminal Investigative Service, Department of Labor OIG, and Air Force Office of Special Investigations.

Construction Company, Owner, and Sister Indicted for Money Laundering

On July 10, 2015, a grand jury in Guam filed a superseding indictment in Federal court against a construction company, its owner, and his sister. The indictment included new money laundering charges against the company and the two individuals.

The firm and the two relatives were previously indicted for visa fraud, conspiracy to commit visa fraud, conspiracy to defraud the United States, illegal harboring, and forfeiture. Case agents had served a seizure warrant to a bank for approximately \$1.9 million. The bank immediately froze the funds and issued an official check payable to the U.S. Department of the Treasury. Immediately following the bank seizure, the company's owner was located at his firm and arrested.

The investigation revealed that he misused the H-2B visa worker program while working on 8(a) set-aside contracts. Moreover, he had a prior criminal history associated with a similar 1998 visa fraud violation which he failed to disclose within his 8(a) application or any of the construction company's annual updates to SBA. His prior criminal history and present misuse of the H-2B visa program are violations of the 8(a) Program's entry and continued eligibility requirements related to "good character." Due to the non-disclosures, the company was granted 8(a) status and awarded 8(a) set-aside contracts in excess of \$20 million.

IRS CI is the lead on this investigation. SBA OIG and Homeland Security Investigations are joint case agencies and will continue to pursue possible violations of Federal criminal statutes, including conspiracy to defraud the United States.

Agency Management

Report 15-14: SBA's Controls to Prevent Duplication of Benefits with Community Development Block Grants

Only July 31, 2015, OIG issued a report concerning SBA's controls to prevent duplication of benefits with community development block grants (CDBGs), which are administered by the Department of Housing and Urban Development (HUD). In the event of a disaster, multiple Federal, State, and local agencies and governments are often involved in providing disaster assistance. When agencies do not coordinate and ensure that one recipient is not receiving benefits from multiple agencies for the same purpose, there is a potential for overlap in funding. This overlap is considered a duplication of benefits. SBA's role to prevent duplication of benefits with HUD's CDBG Program is to provide timely, accurate, and complete loan information to HUD grantees that administer

the grants for HUD. OIG determined that SBA's internal controls to prevent duplication of benefits were adequately designed and generally working as intended. OIG found a few instances where SBA did not timely annotate in the loan file that a grant had been awarded. However, no benefits were duplicated since the disaster survivor had not requested a loan, loan reinstatement, reconsideration or reacceptance, or increase of a loan from SBA after they were awarded CDBG fund.

**Office of Inspector General
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